

and social cost". The China Development Research Foundation said the policy had resulted in social conflict, high administrative costs and a long-term gender imbalance.

In order to remedy this, the changes to the one-child policy and labour camps were part of a key policy document released by the official Xinhua News Agency following a four-day meeting of party leaders in Beijing. China is now loosening its decades-old one-child policy by allowing two children for families with one parent who is an only child.

However, many economists argue that the policy may not have as much of an impact as people think because living in the cities is expensive. Children expected to be born as a result of the policy shift will add modest growth. Population experts estimate 1 million to 2 million births over the next three years, starting at least 9.5 months from now at the earliest. These children won't enter the workforce for another 20 years.

"There's no exact optimum number to add," said Mr. Wang. The Shanghai government found in a 2012 survey that couples born after 1980 are willing to have only 1.2 children on average. The average number of children born per couple in the city is 0.7, well below the rate of population replacement, according to census data.

According to New York University economics professor Ann Lee, who specializes in China's economy, if a significant number of women do decide to have more children, it may create a labour shortage in the short term as women leave the workplace to care for the children. As China's economy strengthens, it will likely follow the path of Europe and the United States, where women following careers

have fewer children and wait longer to have them. However, this change in policy may address the issue of China's status as the nation with the most abortions, including forced abortions and sex-selective abortions, which has caused unrest and skewed China's sex ratios.

References:

1. <http://www.usatoday.com/story/news/world/2013/11/15/china-one-child-rule/3576803/>
2. <http://www.usatoday.com/story/news/world/2013/11/15/china-one-child-policy/3570593/>
3. <http://www.bbc.co.uk/news/world-asia-china-24957303>
4. <http://www.npr.org/2013/11/19/246154509/china-eases-one-child-policy-whats-next>
5. <http://china.adoption.com/chinese/china-adoption-background.html>
6. <http://online.wsj.com/news/article/SB10001424052702303289904579199431427590394>
7. http://en.wikipedia.org/wiki/Demographics_of_China

Regional trade agreements: building or stumbling blocks to global trade?

Parnika Dar
III Year

People and economists started accepting the idea of free trade only after Adam Smith's 'The Wealth of Nations' in 1776 and David Ricardo's theory of comparative advantage. Trade reform has three approaches: unilateral, bilateral/regional

and multilateral. Out of these, multilateral and bilateral trade agreements have an advantage as they lead to greater trade liberalization, increase in market efficiency and encourage specialization among countries. Most countries now are moving towards regional trade agreements due to various reasons including the failure of the recent Doha round negotiations along with the inability of the WTO to liberalize trade in agriculture, textiles and apparel.

The following are the reasons behind countries opting for regional trade agreements (RTAs):

1. Dissatisfaction with the current multilateral trade regime

Frustration with the current multilateral trade regime is one of the main reasons for the growth of regionalism. Many countries find it easier to negotiate and deal with the issue of trade barriers on a regional or bilateral level. After the Uruguay round of WTO, countries are more concerned about global trade since most of the promises of the Uruguay round have not been kept. Expansion of trade in agriculture, textiles and services, particularly in the developing countries, has been quite dismal. Developing countries are moving towards regionalism because of the protectionist policies followed by the developed countries and their unwillingness to open up their markets.

2. Bandwagon effect of regionalism

The adoption of regionalism by USA has led to an increase in RTAs since 1990s. Developed countries such as the USA and the European Union are now becoming a part of free trade agreements with developing countries on a regional level. This has encouraged many developing countries to become a part of these free trade agreements so that they are not

excluded from these markets. The countries which are left out form regional trade agreements among themselves. This, according to the economist Jagdish Bhagwati, creates a bandwagon effect where no country wants to be left out of some major regional groupings.

3. Other factors

Countries also form regional trade agreements due to various political reasons. Regional trade agreements help in building better relations among nations. Countries learn to cooperate and this reduces conflicts and leads to peaceful living. There is also a feeling of security among the members.

According to the World Trade Report, foreign direct investment is an essential source of foreign capital inflow. So in order to attract FDI, developing countries are going in for regional trade agreements. Developed countries like the USA and the European Union have formed RTAs with developing countries in order to take advantage of the benefits of investment and trade.

Economic impact

According to Viner, the net effect of trade liberalization is not always positive. He has coined two terms to explain this: trade creation and trade diversion. Trade creation takes place when inefficient domestic production is replaced by efficient products imported from countries that are a part of RTAs. For example, country A produces refrigerators at \$140 per unit and there is a 50 percent tariff on refrigerators not produced within the country. Country B produces refrigerators at \$130 per unit. If there is free trade agreement between the two countries, then consumers of country A can purchase a refrigerator for \$130 and country A can stop production of refrigerators and produce something in

which it is more efficient. Trade thus allows for greater efficiency in production and lower consumption prices. Trade diversion takes place when a country imports high-cost products from partner countries instead of purchasing low-cost and efficient products from non-member countries. This reduces tariff revenues and essentially leads to subsidization of less efficient producers. Therefore we can say that trade creation increases a country's welfare whereas a trade diversion has the opposite effect. The net effect, i.e. whether a regional trade agreement is positive or negative, depends on which effect dominates the other.

However, countries should benefit from regional trade agreements since with removal of trade barriers, countries are able to purchase products at the cheapest rates from competitive suppliers, and this enhances efficiency and increases welfare. Also, if member countries are geographically closely situated, then they will be highly dependent on each other. Thus, trade diversion will be very low.

Trade diversion is likely to dominate trade creation, particularly when the countries of the RTA have small economies. In case of multilateral trade regimes, trade diversion will dominate trade creation. An important point to be noted here is that there is an assumption of full employment in trade diversion.

In March 1991, after signing The Treaty of Asuncion, Argentina, Brazil, Paraguay, and Uruguay formed a customs union called the Southern Common Market. The customs union is commonly called as MERCOSUR. It created a market which was integrated and the member countries imposed a common tariff on goods imported from non-members. Although Mercosur has been a major success and the value of trade among the nations has tripled, but there is a cost

associated with RTAs relative to multilateral trade liberalization. Mercosur consumers are forced to pay higher prices for certain imports and advanced technology is unavailable for their use. As a result, their incomes are falling and economic growth is also slowing down. Hence, it can be said that Mercosur has produced a considerable amount of trade diversion.

In 1989, Canada and United States implemented a free trade pact called North American Free Trade Agreement (NAFTA). In 1994, they broadened the agreement to include Mexico. Since NAFTA has come into effect, trade among countries has more than tripled. Foreign direct investment inflow in these countries has increased tremendously and Mexico has become one of the largest recipients of FDI. There has also been a rise in the employment rate in North America. 40 million jobs have been created since 1993. NAFTA has led to greater market competition and provided countries access to advanced technology, investments and materials. This has stimulated economic growth in North America. Thus, it can be said that NAFTA has led to trade creation and has had a positive impact on the welfare of the nations and the people.

Conclusion

The benefit of RTAs is largely because of the favourable impact they have on trade creation. However, the underlying assumption that there is full employment and that there are no economies of scale does not exist in countries today. Trade creation may result in loss of livelihood and employment for a section of the population, although the consumer will get goods at cheaper rate. For example, in Mexico small producers and peasantry lost their jobs. Similarly, trade diversion may provide some employment opportunities in periods of

recession, as happened in Mercosur countries. Therefore, we cannot have a doctrinaire approach and say that regional trade agreements are beneficial or detrimental to global trade. Each regional trade agreement will have to be assessed individually in terms of its impact on trade creation, trade diversion, employment opportunities, economies of scale etc.

References:

1. Bhagwati, J. (1993): "Regionalism and Multilateralism: An Overview," *New Dimensions in Regional Integration*, eds J.Melo and Panagariya, Cambridge University Press, Cambridge.
2. Krugman, P (1993): "Regionalism versus Multilateralism: Analytical Notes", *New Dimensions in Regional Integration*, eds. J. de Melo and A. Panagariya, CUP, Cambridge.
3. Viner, Jacob(1950):*The Customs Union Issue*, Carnegie Endowment for International Peace, New York.
4. Summers, L (1991): *Regionalism and the World Trading System -Policy Implications of Trade and Currency Zones*. Wyoming: Federal Reserve Bank of Kansas City

Economies of Trust and the Financial Crisis

Sunanda Pradhan
St. Xavier's College, Kolkata

Trust makes the world go round. It is the most pervasive cultural characteristic influencing a nation's prosperity and its ability to compete. Trust enables people to do business with one another, which in turn creates wealth. Trust and growth are positively related and are mutually

reinforcing in nature. If the society's levels of confidence and trust are low, it leads to inefficiency of markets and institutions, causing the economy to settle in an inefficient equilibrium in a multiple equilibria model of growth.

As critical as trust in both government and business is for our political and economic system, faith in other people maybe more important. Trust in other people, or generalized trust, is a central factor in shaping both social cohesion and institutions that function well. The roots of generalized trust and confidence in institutions are not the same. Confidence in institutions largely reflects current performance of the economy. Moreover, confidence is less variable than trust in government.

A crisis of confidence portends a loss of public trust, and there is no better example of this than the American banking industry that bred the global financial crisis of 2008. The financial crisis, originating from monetary excesses, caused a housing boom followed by a bust which eventually threatened the total collapse of financial institutions. Banks ultimately had to be bailed out by national governments. Stock markets around the world also witnessed a downturn.

From 2000, the Federal Reserve started easing the lending standards and held its target interest rates well below monetary guidelines. The Federal Funds rate fell by 11 times, from 6.5% in May 2000 to 1.75% in December 2001. This created a flood of liquidity in the economy. It was cheap money which was easy prey for restless bankers and borrowers who had no income, jobs or assets. The complex interplay of subprime lending and adjustable-mortgage lending lead to exuberant risk taking due to